

Focus &gt; Global Economy

## Iraq, the Dollar and the Euro

By **Hazel Henderson** | Monday, June 02, 2003

*The euro is finally taking its place alongside the U.S. dollar as a new global reserve currency. This has been further enhanced by the euro's recent gains against the dollar. But what would happen to the U.S. economy if OPEC decided to use euros, instead of dollars, to price oil? Hazel Henderson explores the consequences.*

Futurists like me specialize in “what if” scenarios, outside the box thinking and trying to anticipate surprises. In even the best-laid human plans, events rarely unfold as predicted — even by experts.

### Blind spots

Mostly, these surprises are the result of “blind spots”, or because experts use different models or specialized approaches and languages — making communication difficult.

One such surprise scenario is rooted in the close relationship between oil, dollars, gold and Europe's euro currency. Remember back in 1973, OPEC countries quadrupled the price of their oil and tied it to the U.S. dollar.

Over the years, this flooded the world with “petro-dollars”, which were recycled through banks as loans. The U.S. dollar reigned supreme as the world's de facto reserve currency.

### A history of dollars

Everyone wanted to own dollars, which were considered as good as gold (even though, since 1971, dollars cannot be redeemed for gold, after President Nixon shut the gold window).

Gold no longer backs the dollar — or any other currency. All currencies since 1973 are called “fiat” currencies — backed only by the faith markets have in a country's government and its economic fundamentals.

### Volatile markets

Central banks that used to keep gold bars in their vaults have sold much of their precious metal. Now, they try to “manage” their currencies by raising or lowering interest rates, buying and selling them in the open market and other techniques.

Gold is still popular for jewelry and as a safe haven. It trades actively on the world's commodity and futures exchanges, along with platinum, oil, hogs, coffee, sugar — and fiat currencies themselves.

These currency markets, oil and gold markets are very volatile — dependent on the expectations about the future of millions of their investors and speculators.

### **What drives the markets?**

These markets reflect a collective speculation on the future of such items as Iraq, U.S. foreign policy, the Middle East, oil supplies, alternative energy sources and technologies, the rise of China, the expansion of the EU — and the weather.

They all drive today's global financial markets, including the \$1.5 trillion of daily currency trading.

### **Losing ground**

In the past 12 months, the U.S. dollar has lost some 30% of its value against the European euro. The Bush Administration has played up the bright side. The cheaper dollar makes it easier for U.S. exporters to sell abroad.

The United States needs to increase its exports because it has a whopping trade deficit (currently reading 5.2% of our GDP). Former Treasury Secretary Paul O'Neill dismissed this as "a meaningless concept."

But global investors and currency speculators take it seriously — along with the bursting of the U.S. stock market bubble, accounting scandals and heavily indebted corporations and consumers.

### **No surprise**

The list goes on, and includes the U.S. savings rate at almost 0%, the increasing budget deficits due to President Bush's tax cuts and his build-up of military spending, the Iraq war and the new Bush doctrine of preemptive attacks on any country that might threaten our future national security.

In light of all that, global investors started unloading dollars and U.S. assets. No surprises here.

### **A new global reserve currency**

But as countries that formerly held mostly U.S. dollars in their currency reserves begin to diversify into euros, the currency has taken its place alongside the dollar, as the world's other global reserve currency.

While current data are hard to come by, the euro now accounts for as much as 35% of global trade and reserve holdings. This new reality makes for a more stable world — and takes the unsustainable burden of the sole reserve currency status off the U.S. dollar.

Clearly, with its enormous, open-ended commitments in the global war on terrorism, the U.S. economy cannot at the same time, continue to absorb most of the world's exports — and remain the locomotive of the world's economic growth.

### **An oblivious administration?**

This new situation seems a surprise to the Bush Administration. It is still keen on expanding its overseas commitments, re-building Iraq — and offering aid packages to Turkey, Pakistan and other countries whose support is sought. In the meantime, it has passed a \$350 billion tax cut package in late May, 2003.

While Mr. Bush tells Americans to continue shopping, traveling and enjoying the American way of life, federal deficits grow, domestic programs are cut — and half of all U.S. states are engulfed in budget crises.

### **Dropping the other shoe**

What happens if global investors continue pulling out of the United States — and the dollar keeps falling? Many market players expect it to fall another 20%. Other countries that have lost money in the dollar's fall may continue buying more euros.

The other shoe may drop, too. OPEC may decide to officially re-denominate their oil in euros (since most of the organization's customers are in Europe anyway).

OPEC economists have been considering this "no-brainer" scenario for sound financial reasons — even though they feared U.S. wrath and retaliation.

### **War speculation**

Indeed, many believe that a deeper reason for the U.S. attack on Iraq was its decision in 1999 to require payments for its oil for food program in euros.

The United States — heavily dependent on imported oil — benefits price-wise and in influencing markets through OPEC's U.S. dollar pricing. Iraq's dinar will also be replaced by dollars — if the United States has its way.

### **A major adjustment**

Thwarting President Bush's global dollar diplomacy and its designs on breaking OPEC's oil pricing power provide additional reasons for OPEC to switch to payments in euros. This would mean that the United States would have to buy euros with dollars before it could buy OPEC oil.

The dollar would fall further — and the euro would rise. The U.S. economy would eventually have to adjust to \$5-a-gallon gasoline (the average world price).

The bad news would be a deeper U.S. recession, SUV owners would suffer while Toyota and Honda would grab more market-share with their 50-60 mpg hybrid cars.

### **Good news?**

The good news would be that U.S. exports would flourish and that Detroit would accelerate its own fuel-efficient car production. The solar and renewable energy technologies would be fully capitalized as a new sustainability sector of the U.S. economy, providing millions of new jobs.

And the Bush Administration would have to pull back from its over-

commitment to the global war on "evil" — and shift its priorities to funding education, homeland security and federal grants to help states fund their new mandates.

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